Internal Revenue Service

memorandum

TL-N-8321-89
DAMustone

date: AUG 9 1989

to: District Counsel, Salt Lake City SW:SLC
Att'n: David L. Miller

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: Technical Advice - [redacted]

It has been requested that we provide technical assistance with respect to the above taxpayer. The underlying examination is part of the Coordinated Examination Program (CEP), but the issue involved is not reported in the current CEP Tracking Report. This matter was previously the subject of informal Tax Litigation advice.

ISSUE

Whether I.R.C. § 404 governs the deductions of the monies owing a sweepstakes winner who is neither employed by or provides services to the sponsor of the contest.

CONCLUSION

Section 404 only applies to the deferral of compensation or welfare benefits which a taxpayer provides to its employees and independent contractors. Therefore, that provision is not applicable to the sweepstakes involved here.

FACTS

A subsidiary of the taxpayer ran, as a store promotion, a bingo-type game for shoppers during its fiscal year ending [redacted]. The winners of the bingo game were eligible for the grand prize drawing for $[redacted], which was to be paid in equal annual installments ($[redacted]) over [redacted] years. The winner was selected in mid-[redacted] and the first installment was paid on [redacted]. It is presumed that the winner was not an employee of the sweepstakes sponsor and did not render services in exchange for the prize.

For income tax purposes, the taxpayer originally claimed the amount of the first installment, plus the present value of the remaining prize money ($[redacted]), as a deduction in the [redacted]

09039

taxable year. The taxpayer is now claiming, however, that it is entitled to deduct the total prize money in [redacted] and hence, its income for that year should be decreased by the difference between what it originally claimed on its [redacted] return and the $[redacted] ($[redacted]). The position of the district director is that only the prize money which was actually paid out in the [redacted] taxable year is deductible in that year. Two grounds for this position have been proffered: Section 461(h) or, alternatively, § 404. The applicability of § 461(h) was not raised in the underlying technical advice request; accordingly, it is not in issue here.

DISCUSSION

In general, § 404(a) only applies to those deferred payments which constitute compensation. Treas. Reg. § 1.404(a)-1(a)(2). See, e.g., Don E. Williams Co. v. Commissioner, 429 U.S. 569, 575 (1977); Grant-Jacoby, Inc. v. Commissioner, 73 T.C. 700, 712-13 (1980); New York Post Corp. v. Commissioner, 40 T.C. 882, 886-87 (1963). Thus, the applicable regulations expressly provide that this Code section "does not apply to a plan which does not defer the receipt of compensation ... ." § 1.404(a)-1(a)(2). At the same time, compensation is, in tax parlance, generally understood as that which is paid to another for services rendered. See, e.g., Commissioner v. LoBue, 351 U.S. 243, 247-48 (1956); Old Colony Trust Co. v. Commissioner, 279 U.S. 716, 730 (1929); Casper v. Commissioner, 805 F.2d 902, 905 (10th Cir. 1986); Grant-Jacoby, Inc. v. Commissioner, at 708. Consequently, for purposes of the Code, it is recognized that compensation is not synonymous with income. See, e.g., Herbert v. United States, 850 F.2d 32, 35 (2d Cir. 1988). See also Central Illinois Public Service Co. v. United States, 435 U.S. 917, 919 (1978) (wages and income not synonymous). There is, therefore, nothing in the language of § 404(a) which supports the claim that the deduction of deferred non-compensatory income, such as the prize money involved here, is subject to that provision.

Nor does I.R.C. §§ 404(b)(2) and 404(d) require a different result. Taking the latter provision first, § 404(d) was enacted into law as part of the Revenue Act of 1978 (P.L. 95-600). The avowed purpose of this provision is to deny

> a deduction for deferred compensation provided under a nonqualified plan to nonemployee participants until that compensation is includible in the gross income of the paticipants.

H.R. Conf. Rep. No. 95-1800, 95th Cong., 2d Sess. 205 (1978)(emphasis added). See, e.g., S. Rep. No. 95-1263, 95th Cong., 2d Sess. 73-74 (1978). In short, all that § 404(d) does

is extend the rules respecting the deductibility of deferred compensation under § 404 to independent contractors. See id.; Treas. Reg. § 1.404(d)-1T (Q&A-1). And, there is nothing in the language of § 404(d) which would support its application to the deferral of monies owing a nonservice provider, as is involved here.

With respect to § 404(b)(2), that provision was enacted in the Deficit Reduction Act of 1984 (P.L. 98-369). It treats any unfunded plan providing deferred welfare benefits (e.g., medical benefits, life insurance, severance pay, and disability benefits) to employees or independent contractors as a plan of deferred compensation for deduction purposes. See, e.g., H.R. Rep. No. 98-432 (Part 2), 95th Cong., 2d Sess. 1282-83 (1984). See generally Treas. Reg. § 1.162-10(a). While not technically compensation for purposes of § 404, the benefits involved here are those which are typically provided to an employee/independent contractor and are compensatory in nature. See generally Greensboro Pathology Associates, P.A. v. United States, 698 F.2d 1196, 1200 (Fed. Cir. 1982). It follows, therefore, that § 404(b)(2) is inapplicable here for two reasons: (1) The prize winner does not provide services to the taxpayer; and (2) the prize money is not a welfare-type benefit.

If you need any further assistance in this matter, please contact David Mustone of this Division at (FTS) 566-3407.

MARLENE GROSS

By: Sarah A. Hall
SARAH A. HALL
Employee Plans Litigation
Counsel
Tax Litigation Division